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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 509

UNITED STATES OF AMERICA

v.

THE STATE OF VERMONT; CUTTING & TRIMMING, INC.; CHITTENDEN TRUST COMPANY OF BURLINGTON; RAINBOW CHILDREN'S DRESS COMPANY OF NEW YORK

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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ANSWER OF RESPONDENTS TO PETITION FOR WRIT OF CERTIORARI

Opinions Below

The opinion of the District Court is reported at 206 Fed. Supp. 951. The opinion of the United States Court of Appeals for the Second Circuit is set forth in Appendix A to the Petition for a Writ of Certiorari and is reported at 317 F. 2d 446.

Questions Presented

1. Whether the rule that federal law governs the question of the relative priority of a federal tax lien and a competing state statutory lien is constitutionally correct in view of the cases holding that there is no federal common law.
2. Whether, if the rule that federal law governs the relative priority of a federal tax lien and a competing state created lien is still followed, the rules of choateness as developed in insolvency cases are applicable to a solvency case where a state lien is identical to the federal lien and prior thereto at every step in the proceedings.

Statutes and Constitutional Provisions Involved

The statutes involved are 26 U. S. C. A. 6321, 6322, 6323 and 32 Vermont Statutes Annotated 5765, and are set forth in Petitioner's Appendix B. Constitutional provisions involved are Amendment V and Amendment X of the Constitution of the United States, and are set forth in Respondent's Appendix B.

Statement

On October 21, 1958, the defendant, Cutting & Trimming, Inc., filed a withholding tax return with the Vermont Tax Department reporting that it had withheld from the wages of its employees for the third quarter, 1958, State income taxes in the amount of $1,628.15. This sum was not paid to the Tax Department. (Tr. 43, Appendix A.*) Thereafter on the same date, the commissioner of taxes for Vermont made an assessment and demand on Cutting & Trimming, Inc., in the amount of $1,628.15. On October 30, 1958, a notice of tax lien was filed in the Burlington city clerk's office for the unpaid taxes. On May 21, 1959, the State of Vermont brought suit to enforce its lien against Cutting & Trimming, Inc., the Chittenden Trust Company being joined as trustee. The trustee filed a disclosure showing it held One Thousand Two Hundred Seventy-eight Dollars and Eighty-two Cents ($1,278.82) as trustee of Cutting & Trimming, Inc.

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* Also Appendix to Appellant's Brief to Court of Appeals, p. 43, Motion to Amend Answer.

On October 23, 1959, judgment was entered by Chittenden County Court for the State of Vermont against Cutting & Trimming in the amount of $4,049.22, and against the defendant, Chittenden Trust Company, in the amount of $1,278.82. The suit was brought to enforce other tax liens held by the State of Vermont against Cutting & Trimming, as well as the tax lien which arose October 21, 1958. (At issue here is only the October 21 lien for only as to this lien does the State claim priority.) Petitioner's Appendix A, p. 15-16.

On February 6, 1959, the Commissioner of Internal Revenue made assessments for outstanding federal taxes in the amount of $5,365.96. A notice of lien was filed on or about June 2, 1959, in the office of the city clerk, Burlington, Vermont.

In 1961 the United States brought suit in the United States District Court, not only to enforce the lien claimed in this case, but for other amounts claimed due but not pertinent to the issue here. A judgment order was rendered by the District Court finding that the State of Vermont was entitled to priority up to the amount of its lien of $1,628.15, plus interest. Final judgment was entered, and the United States appealed to the United States Court of Appeals for the Second Circuit. The Court of Appeals affirmed the judgment of the District Court on May 9, 1963. Petitioner's Appendix A, p. 16. The Court of Appeals held that under *United States* v. *City of New Britain*, 347 U. S. 81, the same tests of choateness which had been formulated by the courts in insolvency cases did not apply to cases where no insolvency was involved. It held that since the Vermont statute created a lien which was identical to the federal lien, and which was, under the *New Britain* case, as general or specific as the federal lien, the same standards applied and that the cardinal principle of first in time, first in right, was applicable. Thus, the Vermont tax lien had priority over the federal lien. Petitioner's Appendix A, 16-30.

Argument

1. The rule that it is a matter of federal law as to when a lien created by state law "has acquired sufficient substance" . . . "as to defeat a later arising federal tax lien" should no longer be followed.

The Court has heretofore taken the view that the question of the relative priority of a federal tax lien and a competing statutory lien is governed by federal law. *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47; *United States* v. *City of New Britain*, 347 U. S. 81; *United States* v. *Pioneer American Insurance Co.*, 374 U. S. 84. The rule developed in the early cases, and apparently has not been challenged before this Court in recent years. The Court has paid heed to state law under some circumstances.

> "Yet because federal liens intrude upon relationships traditionally governed by state law, it is inevitable that the Court in developing the federal law defining the incidents of such liens, should often be called upon to determine whether, as a matter of federal policy, local policy should be adopted as the governing federal law, or whether a uniform nationwide federal rule should be formulated."
>
> *United States* v. *Brosnan*, 363 U. S. 237, 240.

In *Brosnan* the Court adopted, as federal law, state law "governing the divestiture of federal tax liens." *Supra*, p. 241. Earlier the Court applied state law in determining the extent of the "property and rights to property" to which a government tax lien attaches. *United States* v. *Bess*, 357 U. S. 51, 55.

In asserting that the question of the priority of a federal tax lien is a federal question and in developing certain rules relating thereto, the Court has apparently taken the view that there is some federal common law governing priorities, for the federal tax lien statute is silent on the matter. There is no indication in the federal statutes that a state created lien must be choate or perfected in some way to prevail over a federal tax lien. Such a rule would seem to be no longer applicable in view of the cases which have held that there is no federal common law. *Erie Railroad Co.* v. *Tompkins*, 364 U. S. 64; *Wheelden* v. *Wheeler*, 373

U. S. 647. Also see *United States* v. *Certain Property, etc.*, 306 F. 2d 439. In other words, the federal courts should apply state law in determining when a state created lien becomes effective. To permit a federal tax lien to gain priority over an earlier arising state lien because of supposed federal common law rules as to when the state lien takes effect is to ignore the Tenth Amendment to the United States Constitution. The Constitution has not delegated to the Federal Government the right to determine the effectiveness of liens created by state law, nor has the Constitution or Congress given the Federal Courts the right to make such a determination and, thus, decide on the validity of property interests arising thereunder. Furthermore, to give a junior federal tax lien priority over many state liens, such as mechanics' liens, because of federal rules of choateness in conflict with state laws as to when a state lien arises, is to take property without due process and in violation of the Fifth Amendment to the Constitution of the United States. Significant in this connection are:

Chicago Federal Savings & Loan Assn. v. *Cacciatore*, 25 Ill. 2d 535, 185 N. E. 2d 670;
Milton Savings Bank v. *United States*, 187 N. E. 2d 379.

2. A state tax lien which is identical to the federal tax lien and which arises earlier has priority.

Even if the priority of the federal tax lien is still considered a federal question, the Court of Appeals was correct in upholding the priority of the Vermont tax lien under the facts of this case.

The Vermont tax lien is identical to the federal tax lien as to the time it arises, its duration, the property to which it attaches and the method of enforcement. The State's lien arises "at the time assessment and demand is made by the commissioner of taxes and shall continue until liability of such sum, with interest and costs, is satisfied, or becomes unenforceable." 32 V. S. A. 5765. The lien of the United States arises "at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time." 26 U. S. C. A. 6322. The liens are "upon all the property and rights to property, whether real or personal" belonging to

the taxpayer. 32 V. S. A. 5765; 26 U. S. C. A. 6321. Court action was brought by both the United States and the State of Vermont to enforce their respective liens. Petitioner's Appendix A. It can readily be seen, then, that one lien is as specific or general as the other.

Vermont was ahead of the United States at every step in the proceedings. Assessment and demand was made first, a tax lien was filed first and suit was brought first to enforce the lien which arose at the time of assessment and demand. Petitioner's Appendix A. The federal statutes being silent as to the relative priority of a federal tax lien and a competing state created lien, the general rule of "first in time, first in right", applies. *United States* v. *New Britain, supra.*

This case is distinguishable from the many cases where the Court has upheld the priority of the federal tax lien as against various competing interests. No case has been decided by the Court which is directly in point. In many of the cases, the amount of the competing lien was uncertain at the time the federal lien arose. *United States* v. *Texas,* 314 U. S. 480; *United States* v. *Acri,* 348 U. S. 211, and others. Distinguishable also are the garnishment cases (*United States* v. *Liverpool & London Insurance Co.,* 348 U. S. 215), the attachment cases (*United States* v. *Security Trust & Savings Bank, supra*) and the mechanics' lien cases (*United States* v. *White Bear Brewing Co.,* 350 U. S. 1010).

In all of these cases "numerous contingencies might arise that would prevent the lien from ever becoming perfected by a judgment awarded and recorded." *United States* v. *Security Trust & Savings Bank, supra.*

The same reasons do not hold true here where assessment and demand was made based on admitted liability of the taxpayer. Respondent's Appendix A.

In cases arising under 31 U. S. C. A. 191, involving insolvency, the Court has prescribed certain tests of choateness. *Illinois* v. *Campbell,* 329 U. S. 362. The priority of the United States is clearly set forth by statute in such cases.

> "Whenever any person indebted to the United States is insolvent . . . the debts due the United States shall be first satisfied." 31 U. S. C. A. §191.

In *Illinois* v. *Campbell, supra,* p. 375, the Court said that in order to prevail over a federal lien arising under Section 191, a competing lien must be choate or perfected in the sense that (1) the identity of the lienor, (2) the property subject to the lien and (3) the amount of the lien are established. Since Section 191, by its terms, confers priority upon the lien of the United States, it is readily apparent why the strict test of choateness was developed. There is no reason to apply such tests to non-insolvency cases where the statutes are silent as to priority.

Unfortunately the Court has referred to the choateness test in other cases, such as *United States* v. *Pioneer American Insurance Company, supra,* when it was not necessary to a decision in the case. However, the Court clearly recognized that insolvency and non-insolvency cases should be treated differently and said so in *United States* v. *New Britain, supra.* It is interesting to note that the Court has never yet upheld the priority of a competing lienor in insolvency cases; yet it has in cases where no insolvency was involved. *United States* v. *New Britain, supra.*

Since we have two identical competing tax liens and with the State of Vermont and the United States equally in need of means of enforcing the collection of tax revenues, there is no reason in law or equity why the same principles should not be applied to both. To hold otherwise is to impose an unjustifiable double standard contrary to the long established rule of lien priority "first in time, first in right."

Conclusion

Despite the aforegoing, the State recognizes that an important question is at issue with no decision of this Court directly in point and agrees that a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A

[Tr. 43]

[Caption omitted]

Motion For Leave To Amend Answer

[Filed March 8, 1962]

Now comes the State of Vermont, a defendant in the above-entitled cause, by its Deputy Attorney General Charles E. Gibson, Jr., and respectfully moves for leave of the Court to amend the Answer by adding at the end of paragraph 13 the following language:

"That the aforesaid assessments were made on the basis of a quarterly withholding tax return filed on October 21, 1958, by the defendant, Cutting & Trimming, Inc., with the Vermont Tax Department, said return reporting that the amount of $1,628.15 was withheld by Cutting & Trimming, Inc., from the wages of its employees for the third quarter 1958 and a withholding tax return filed on February 7, 1959, by the defendant, Cutting & Trimming, Inc., had withheld from the wages of its employees for the fourth quarter 1958 the amount of $964.08. The defendant, Cutting & Trimming, Inc., failed to pay the amounts for which it was liable to the State of Vermont as set forth in its withholding returns aforesaid, assessments and demands were made as indicated heretofore and suit was brought by the State of Vermont to enforce its tax liens."

The ground for this motion is that the additional language was omitted in the Answer and is relevant, material and essential in order for there to be a fair adjudication of this case.

STATE OF VERMONT,
by CHARLES E. GIBSON, JR.,
CHARLES E. GIBSON, JR.,
Deputy Attorney General.

March 7, 1962.

(Same as Appendix to Appellant's Brief to the United States Court of Appeals, p. 43.)

APPENDIX B

United States Constitution.

Amendment V. [Criminal indictment; double jeopardy; self incrimination; due process; compensation for taking private property.]

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment of indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any Criminal Case to be a witness against himself, nor to be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Amendment X. [Powers reserved to the states.]

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.